

## Priority, Overreaching and Surprises under the Land Registration Act 2002

Before the advent of title registration, if a transaction was tainted by a vitiating factor, one would ask whether the transaction was void or voidable and, if the former, the *nemo dat* rule would apply and the innocent victim would recover their title unencumbered by any dealings that the wrongdoer had sought to transact. Now, under the Land Registration Act (LRA) 2002 as it has been interpreted in *Swift 1st v Chief Land Registrar* ([2015] EWCA Civ 330; [2015] Ch. 602), a victim gets no comfort from the *nemo dat* rule. If they wish to recover their title, they must instead establish either that they have proprietary priority over the current registered proprietor (under ss. 28 or 29 of the Act) or else achieve rectification of the register under Schedule 4 of the Act. Failing these, they are left with the possibility of an indemnity under Schedule 8 of the Act. In *Updating the Land Registration Act 2002: A Consultation Paper* (Law Com. No. 227 (2016)), the Law Commission indicate that they would not change the disapplication of the *nemo dat* rule given that this enhances the central aim of title security (para. 5.35 *et seq*). Unfortunately, of course, wrongdoing does not diminish just because we look at it differently, and in *Mortgage Express v Lambert* ([2016] EWCA Civ 555) the Court of Appeal had to untangle the claims of a duped former title holder and the innocent lender that now held a registered charge granted by the wrongdoers. In doing so, Lewison L.J. (with which Gloster L.J. and Cobb J. agreed without addition) considered the interplay between the priority rules and owners' powers provisions of the LRA 2002 and the overreaching provisions of the Law of Property Act (LPA) 1925. His conclusions are surprising, revealing and challenging.

Ms Lambert was the registered proprietor of a leasehold flat worth around £120,000 on the open market. She was "in desperate financial straits" (*Lambert* at [1]) but the internet offered a solution in the form of Mr Sinclair and Mr Clement with whom she agreed as sale at £30,000. This was duly completed with the purchasers taking title jointly, paying the price by means of a bridging loan. Ms Lambert did not, however, quit the property and one issue was whether she retained some form of tenancy after the sale – a classic purported sale/leaseback of the type at the heart of the litigation in *Scott v Southern Pacific Mortgages* ([2014] UKSC 52, [2015] 1 A.C. 385). The trial judge thought that this might even be a 90-year lease by application of the saving grace of *Berrisford v Mexfield Housing Co-operative* ([2011] UKSC 52; [2012] 1 A.C. 955) but the existence of any lease proved unsustainable (see below). As the new owners under a contract of sale, Sinclair and Clement then obtained a mortgage from

Mortgage Express for just under £105,000. The purchasers' title and the mortgage were registered on the same day. Some six months later, title was transferred into Sinclair's sole name (with Mortgage Expresses' consent) but he defaulted on the payments and the mortgagee sought to exercise its remedies. Ms Lambert has fallen behind with her "rent" and resisted possession on the ground that the initial sale should be set aside and that this gave her priority over the mortgagee. The trial judge accepted that the initial sale was tainted by unconscionability but that this did not bind Mortgage Express because it was a *bona fide* purchaser for value without notice (Lambert at [6]). Lewison L.J., with perhaps enormous self-restraint, simply notes that the doctrine of notice has nothing to do with registered title. Indeed, it is remarkable that even in 2016 that this has not permeated to all levels of the Bench and Bar. Perhaps the less said about this the better.

On these facts, Ms Lambert was not in the same position as the claimants in either *Scott* or the earlier *Abbey National Building Society v Cann* ([1991] 1 A.C. 56). It looked like she did have some sort of proprietary interest immediately before the mortgage was executed and registered, because although the mortgage was registered on the same day as the purchaser's title, the sale by then had been completed and financed by the bridging loan. Any right Ms Lambert had must have arisen on the earlier completion funded by the bridging loan (unlike *Scott*) and the mortgage could not be said to be simultaneous with the borrowers' purchase or indeed required for it (unlike *Cann*). So, we are left with a classic priority contest between innocent purchaser and innocent interest holder which allows Lewison L.J. to analyse the priority provisions of the LRA 2002 and the overreaching provisions of the LPA 1925. The result is a surprise.

The first issue is whether Ms Lambert really did have a proprietary interest in the land capable of binding Mortgage Express. Ms Lambert originally pleaded an assured shorthold tenancy, and the trial judge thought it might be a *Mexfield* 90-year term, but this line of argument was abandoned in the Court of Appeal given the finding of fact at trial that the entire transaction should be set aside for unconscionability. The arrangement with Sinclair and Clement could not be both devoid of effect and give rise to a lease of any kind at the same time [*Lambert* at [14]]. This left the argument that the right to set aside the transaction for unconscionability was an "equity" which was now to be treated as proprietary because of s. 116 of the LRA 2002. As Lewison L.J. notes, given that the right to set aside a transaction for undue influence or misrepresentation are unquestionably such equities [*Lambert* at [16] and [23] and the cases cited therein], it is difficult to see why the same is not true if the vitiating factor is unconscionability.

The problem is, however, that the identification of a new equity (or an established equity arising in new circumstances) has the potential unexpectedly to compromise the security of a registered charge (or title) because of the intersection of s. 116 and s. 29 LRA 2002. In this case, the lender is doubly unfortunate because the property was purchased first with a bridging loan pending the completion of Mortgage Express' registered charge. If Mortgage Express' charge had been used to finance the purchase directly, then there would be no question of Ms Lambert's interest having priority (by reason of an overriding interest through actual occupation within para. 2 Schedule 3 LRA 2002) as the lender would have priority as being first in time – *Abbey National Building Society v Cann* ([1991] A.C. 56). Further, Mortgage Express can get little comfort by relying on being subrogated to the priority of the bridging loan that it paid off (which would seem possible – *Equity & Law Home Loans Ltd. v Prestidge* [1992] 1 W.L.R. 137 – even though not pleaded) because Mortgage Express' loan was for some £75,000 more than the first loan. Of course, one might say that Mortgage Express had every chance to discover Ms Lambert and safeguard their priority (perhaps by seeking her consent), although it is difficult to see how they could have suspected that she had a proprietary interest capable of having priority to their charge – more on which below. In fact, Lewison L.J. thinks that there are a number of ways to resolve this problem in favour of Mortgage Express. Not all of these are convincing, but one at least requires us to reevaluate substantially what we thought was a familiar concept.

First, Lewison L.J. suggests that Mortgage Express is protected by s. 26 LRA 2002. This provides that “a person's right to exercise owner's powers in relation to a registered estate or charge is to be taken to be free from any limitation affecting the validity of a disposition”, save as specified in s. 26(2), being when there is a limitation on the register or imposed by the legislation. Further, according to s.26(3), this is to ensure that the “title of a donee” cannot be questioned “(and so does not affect the lawfulness of a disposition).” So, the argument runs, that when Sinclair and Clement mortgaged the flat to Mortgage Express, this was a disposition they could make (there being no limitation in the register or Act) and the title of Mortgage Express *could not be questioned* (emphasis added) even if there was an overriding interest that would otherwise defeat their charge. Indeed, Lewison L.J. points out that there is support for this argument in the Law Commission and Land Registry Report which led to the 2002 Act, because it contains an example which seems to suggest that a purchaser who takes the title apparently subject to an overriding interest is protected by s. 26 and the overriding interest disapplied (*Lambert* at [27] citing para. 4.10 of the Report). If this is correct, it

reduces the role of overriding interests significantly, perhaps rendering them largely otiose, because it gives primacy to s. 26 over s. 29 LRA 2002. It also, of course, contradicts more case law on the effect of overriding interests than can be listed here. However, with respect, this argument is misplaced, and indeed the Law Commission's example is misleading. The purpose of s. 26 is to confirm the *status* of the disponee's title not whether it has *priority*, which is the business of section 29. Section 26 means that the disponee's title is secure even if there was a limitation on the disponor's title, but it says nothing of the effect of overriding interests unrelated to that limitation. In fact, the reason why the occupier in the Law Commission's example does not have an overriding interest has nothing to do with s. 26: it is because, as the facts of the example make clear, she is overreached by a sale by two trustees of land (*City of London Building Society v Flegg* [1988] 1 A.C. 54). The Law Commission is not saying that s. 26 trumps s. 29, but that failing to observe a limitation on a disponor's title not entered on the register does not compromise the disponee's title. With respect, Lewison L.J.'s interpretation is a misreading of the combined effect of s. 26 and s. 29 and would reduce the concept of overriding interests to an echo in the history of land registration.

A second way of preserving Mortgage Express's priority identified by Lewison L.J. relies on the qualification found in para. 2 Schedule 3 of the LRA 2002 – that the interest of a person in actual occupation will not override if enquiry is made of the right holder and the right is not disclosed when it is reasonable to do so. Lewison L.J. notes that Ms Lambert signed a standard contract for sale and gave a full title guarantee when she sold to Sinclair and Clement, including a promise of vacant possession. As we know, this was an untruth, because Ms Lambert believed she had a tenancy under a lease back. In these circumstances, Lewison L.J. felt that Ms Lambert had failed to disclose her interest and thus would lose her priority. There are, however, difficulties with this argument also. It is true that Mortgage Express were supplied with and clearly relied on the conveyancing documents signed by Ms Lambert, and perhaps there is an estoppel argument here (*Lambert* at [43]). But it is unclear whether Mortgage Express can benefit from an enquiry *they* did not make. In any event, the purpose behind the “disclosure condition” is not to put an obligation on the right holder to actively reveal an interest that would safeguard their priority (and which they may not even know they have – as here, *Lambert* at [41]), but rather to give the right holder an opportunity to disclose when reasonably questioned about their status (*Begum v Isa* [2014] EW Misc B51 (CC)). Perhaps the line is a fine one, and perhaps Ms Lambert would have been estopped, but interpreting the completion of normal conveyancing documents as a failure to disclose, when

the specific reason for requiring disclosure is not made clear, is a generous pro-purchaser interpretation of the 2002 Act.

Thirdly, and most significantly of all, Lewison L.J.'s main and decisive reason for rejecting Ms Lambert's claim of priority was that her "mere equity" arising from the unconscionable conduct of Sinclair and Clement was overreached when these joint owners charged the flat to Mortgage Express (s. 2(1)(ii) LPA 1925 and *Flegg*). This is significant. Ms Lambert's interest was not an equitable co-ownership interest under a trust of land, the usual overreachable interest. It was a mere equity arising from unconscionability. But, as Lewison L.J. points out after a careful and persuasive analysis of the overreaching provisions of the LPA 1925, there is nothing to suggest that this and other types of equitable interest cannot be overreached, save those specifically excluded from overreaching in s. 2(3) LPA 1925. So, mere equities and interests arising by estoppel (*Birmingham Midshires Mortgage Services Ltd v Sabherwal* (2000) 80 P. & C.R. 256) are capable of being overreached along with interests behind trusts. At first reading, this looks remarkable – surely it is only interests behind trusts that are overreachable for these are easily quantifiable in money as they represent a "share" of the value of the land? But, as Lewison L.J. demonstrates, this is just an assumption and the legislation clearly imposes no such limitation. We – especially the academic community – have failed in the most basic of skills: reading the statute. Indeed, on reflection, it is not even that surprising that equitable rights other than interests behind trusts can be overreached. If the "solid" equitable co-ownership share is overreachable, why not the mere equity arising from undue influence, misrepresentation and unconscionability, and the equity by estoppel. All of these other rights are, in truth, more like claims to relief than being substantively valuable and why should a purchaser who complies with s. 2 LPA have to suffer these claims when they were not the wrongdoer. Perhaps the drafters of s.2 were more prescient than we have given them credit for. That is not to say, however, that this analysis is problem free, for it leaves us with some practical problems. For example, given that the effect of overreaching is to displace the interest overreached from the land into the capital money paid, how do we value an equity arising by undue influence, misrepresentation and unconscionability? Do we say that the overreached right holder is entitled to one hundred per cent of the money paid because the vitiating factor destroys the whole transaction, or do we have to quantify its effect? Also, for estoppels that are overreached, is it relevant that the concrete remedy for the estoppel might have been a proprietary interest that is not

overreachable (e.g. an easement) or is “estoppel overreaching” available only when the estoppel would have been satisfied by a “family” type interest (as in *Sabherwal*)?

*Lambert* reminds us to take nothing for granted and it requires us to re-learn what we understand by overreaching. Overreaching is not as narrow as many of us had believed.

*Lambert* also provides a convenient and balanced solution to the troublesome scenario of an innocent purchaser (Mortgage Express) being caught by a property interest (of Ms Lambert) generated by the personal wrongdoing of the previous owners (Sinclair and Clement). And it is a counterweight to s. 116 LRA that otherwise might cause extra burdens for disponees. But only, of course, if there at least two legal owners. A further puzzle though, is why Mortgage Express bothered at all? After *Swift 1<sup>st</sup>*, they *may* have been entitled to an indemnity from the Land Registry if they had surrendered their charge (depending on one’s view of *Re Chowood* [1933] 1 Ch 574) and Ms Lambert could have sought rectification of the register against Sinclair, who by then was the sole proprietor. There is still more to be done to untangle the relationship between priority, title guarantee, indemnity and rectification. *Lambert* helps.